

The M&A Sector of the Building Services Industry:

Current Status

*OPINION – Gary A. Penrod
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While the economic climate has gotten better, or so we hear, we are not yet out of the woods, so it is not yet time to relax your guard. Expect more of the same for the immediate future. Whether or not the November 2010 election will influence the future is not known, but time will tell. For now, the best advice that can be offered is to; (1) continue to do what worked for you when hit by the Great Recession of 2008, (2) conserve cash, (3) operate efficiently,(4) grow wisely and appropriately and (5) be prepared for the next round, if it happens.

The M&A sector of the building services industry has weathered the Great Recession of 2008 fairly well, although there were fewer transactions completed in 2009 than in previous years. What about 2011 ? What can be expected? We don't know for certain and, based on the many theories expressed in the media, no one else does either. CFO Magazine (December 2010) quoted George Bernard Shaw as saying, “ If all of the economists were laid end-to-end, they would not reach a conclusion.” In some respects, Shaw may have a point, but certainly we can still forecast, using what we know for certain and staying alert to anticipate what is ahead. We at GPA expect the rate of transactions to continue at a near pre 2008 pace. We have experienced a rush in 2010, partly due to the uncertainty about whether or not the current tax rate structure will end or be extended. It has now been concluded that the current tax rate will be extended through 2012. Two years is not a long time, so we expect the rush to continue. Key, of course, is the current capital gain rate of 15% which, after 2012, could rise to 28%, or higher. Therefore, considering everything and unless there is a complete economic meltdown, we expect a brisk rate of transactions for the next two years.

According to the William Blair & Company M&A Market Analysis, November, 2010: “Heading into the final months of 2010, M&A activity remains solidly up for the year and is poised to report its first increase in three years. We expect the fourth quarter to finish strong, as companies continue to take advantage of higher equity prices, loosening credit markets and tax considerations. Private equity activity, particularly in the United States, has picked up significantly over the past several months as the debt markets continue to thaw and firms look to invest the roughly \$400 billion to \$500 billion of committed capital available. In addition, the higher equity valuations have helped push the price multiples up significantly over the past 12 months. We believe that the overall environment for transaction activity remains favorable and all signs point to a strong finish for 2010 and a positive start to 2011.”

How does this relate to the M&A sector of the building services industry ? We at GPA believe that the William Blair & Company conclusion supports what we too have concluded, that is, there are sufficient funds available for transactions in which the buyer is qualified and the seller has a well managed, profitable company that is engaged in providing services in viable market sectors and market areas.

I am pleased to let you know that GPA’s Stay Tuned letters have been generating interest among those that read them, calling or emailing me with a variety of questions and comments, some of which are in agreement with what Stay Tuned has put forth, others that have concluded something different. I encourage this dialog to continue; it provides all of us the opportunity to learn. We do not pretend to be absolute experts, rather, we are observers of M&A activity in the building services industry and how general economic conditions affects that M&A activity. As such, it has certainly been reinforced to us recently that the building services industry is recession resistant. As such, in general, this means that valuation for companies engaged in the industry do hold the valuation line. Most companies engaged in the industry are considered to be small business. Our estimate is that there are about forty thousand building service contractors in the United States, about 70% of which have sales under \$1.5 million, so it is a highly fragmented industry. Whether small or large, these firms, if well managed, provide a good living for its shareholder(s) and do have value for prospective buyers.

As mentioned, we do receive a variety of questions from Stay Tuned readers. Many of the questions ask about specific buyers and buyers in general. While we refrain from speculation about specific buyers, we do point out that there are many qualified buyers that have genuine interest in acquiring companies of all sizes and in all market areas. We also point out that the recent economic situation has piqued the interest of some investor buyers that like industries that provide monthly

recurring revenue and are also recession resistant. That, of course, describes the building services industry. Investor buyers tend to gravitate to companies with adjusted (for add-backs to profit and/or expense) ebitda of \$1.5 million, or more. There are, however, exceptions to this, especially if the investor group already has building services companies in its portfolio.

Prospective sellers that contact GPA express concern about confidentiality. No doubt, confidentiality is an important element in any acquisition effort. It must be appreciated and adhered to by both the buyer and the seller and their key employees and advisors that have any knowledge about the prospective transaction. A agreement of confidentiality must be executed by both parties and it should be executed in good faith. It means that both parties, each being privy to confidential information about the other and that a transaction is being considered, agree to not disclose this information to anyone for any reason that does not have a need to know about the information. The agreement of confidentiality (CA) (sometimes referred to as a non-disclosure agreement (NDA) should be entered in to in good-faith, however, it should not be confused with its being a non-compete or non-solicitation agreement. At some point during the acquisition process, usually during the due diligence phase after specific contract and customer information has been revealed, the prospective buyer may be asked to execute a non-solicitation agreement for the seller's accounts. In most cases, this simply means that the prospective buyer will not actively solicit the seller's accounts during the process or after the process for a specified period of time if the transaction does not close. The buyer, however, if requested by the customer to provide services is usually free to do so, so long as the customer was not solicited by the buyer. It should be pointed out that most transactions that get to the due diligence phase, do close.

We are also frequently asked about the letter of intent (LOI), its meaning and its importance. The LOI is the means used by a prospective buyer to express his intent to acquire the seller's company, specifying the price, price components and general terms. If accepted by the seller, the LOI's no shop provision means that , for the life of the LOI (usually 60 to 90 days) the seller will not actively seek other buyers. While some provisions of the LOI are binding, it is generally non-binding, however, it should be entered in to in good-faith by both parties. Either party can usually, for any reason, terminate the LOI. It does not happen often, but it does happen.

By far, most questions and/or comments that we receive concern valuation. Sometimes, the question is basic, "what is the current multiple ?(referring to the multiple of adjusted ebitda to arrive at price) Since each valuation is unique to a given set of circumstances, there can be no definitive answer to that question. There are rules of thumb, of course, but it can be misleading to apply any

rule of thumb to a specific situation since each company is unique in its performance, market areas, market sectors, retention rate and other important characteristics. Market valuation is not an exact science, but, given specific information about a company, the market valuation process can produce a valuation that is very close to that which interested prospective buyers will agree. Ultimately, of course, the market valuation is determined by what the buyer and seller agree upon.

Good-faith is essential in any serious M&A negotiation. That does not necessarily mean that there will be total agreement on all points, but it does mean that each participant must act in a confidential and professional manner in all aspects of the acquisition process. Compromise too, is essential. I have never seen a transaction close without some compromise on each party's part.

At GPA, we establish all of the necessary ground rules among the parties, providing the confidentiality agreement, non-solicitation agreement and the package of information needed for the process to begin. We are not lawyers, so whether a prospective buyer or seller, each party will need to retain counsel.

We like what we do and do learn from each transaction in which we are involved. So, after 18 years of providing M&A intermediary services to both buyers and sellers in the building services industry, we have accumulated a body of information that serves each of our clients well. We intend to continue serving our clients, adding to our business acumen, transaction by transaction.

In many cases, GPA associates work collaboratively on any given project. Recently, Michelle Sullivan Bettez was joined GPA as an administrative associate. She will work closely with other associates for the sole purpose of providing the best service possible for GPA's clients. All of us at GPA welcome her and look forward to her contribution to our effort.

We remain cautiously optimistic about the economy and very optimistic about the future of the building services industry. As always, I will appreciate and look forward to your questions and comments about this particular Stay Tuned or about activity within the M&A sector of the building services industry that you care to discuss.

STAY TUNED!

A handwritten signature in black ink, appearing to read "Gary", is positioned to the right of the "STAY TUNED!" text.